

Information Memorandum
August 2003

EXCHANGE FUND NOTE PROGRAMME



HONG KONG MONETARY AUTHORITY
香港金融管理局

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Summary of the Terms of the Notes

Issuer	The Hong Kong Special Administrative Region Government (the “Hong Kong Government”) for the account of the Exchange Fund.
Currency	Hong Kong dollar.
Method of Sale	By competitive tender on a bid-price basis or by non-competitive tender, in each case subject to a minimum bid of HK\$50,000. Each tender bid must be for an integral multiple of the minimum denomination of Notes. Applicants submitting bids in a competitive tender must indicate the quantity of Notes applied for and the bid price. Applicants submitting bids in a non-competitive tender only need to indicate the quantity of Notes for which they are applying. Successful bidders in a competitive tender will be allotted Notes at the price which they bid. Successful bidders in a non-competitive tender will be allotted Notes at the average price of the successful competitive tender bids, which will be calculated as the mean of the prices of the competitive tender bids accepted, weighted by the allotment amounts.
Form of Notes	Computerized book entry form in Securities Accounts maintained with the Monetary Authority. Notes will be issued in denominations of HK\$50,000 each and higher integral multiples thereof.
Maturities	The maturity date of each issue of Notes will be announced in advance of each tender.
Interest Rate	Each issue of Notes will bear a fixed interest rate announced in advance of each tender.
Interest Payment	Interest will be paid semi-annually in arrears according to the actual number of days in an interest period and on the basis of a 365-day year.
Interest Period	The first interest period shall be the period from and including the issue date to but excluding the first interest payment date. Thereafter interest periods will run from and including each interest payment date to but excluding the next interest payment date.
Tender Arrangements	Competitive tenders must be submitted through Recognized Dealers by 10:30 a.m. on the relevant tender day. Non-competitive tenders must be submitted through those Recognized Dealers which are also appointed as Retail Exchange Fund Notes Distributors by 12:00 noon on the business day (other than a Saturday) falling immediately before the relevant tender day. Tender results will be announced not later than 3:00 p.m. on the relevant tender day.
Settlement	Settlement will be effected on the first business day (other than a Saturday) immediately following the relevant tender day.
Repayment	The Notes will be redeemed at par on their respective maturity dates.
Status	The Notes will constitute direct, unsecured, unconditional and general obligations of the Hong Kong Government for the account of the Exchange Fund and will rank pari passu with all other unsecured indebtedness of the Hong Kong Government for the account of, and payable from, the Exchange Fund from time to time outstanding.
Legal Title	Legal title to Notes is vested in the holder of the Securities Account, to which the relevant Notes are credited, maintained with the Monetary Authority.
Taxation	The Notes are exempt from profits tax and stamp duty in Hong Kong.
Governing Law	The Law of Hong Kong.
Listing	The Stock Exchange of Hong Kong Limited.
Secondary Market	Market Makers have undertaken to quote bid and offer prices for Notes during normal money market hours (9:00 a.m. to 12:00 noon and 2:00 p.m. to 4:00 p.m. Monday to Friday).
Issuing Agent	Monetary Authority.
Paying Agent	Monetary Authority.

This Information Memorandum is published in English and Chinese. The English version shall be the authoritative version for the purpose of interpretation of words and expressions used in the Information Memorandum whereas the Chinese version is intended merely for ease of reference. In the event of any inconsistency between the English version and the Chinese version of the Information Memorandum, the English version shall prevail.

HONG KONG SPECIAL ADMINISTRATIVE REGION GOVERNMENT EXCHANGE FUND NOTES

Introduction

On 3 March 1993, the Financial Secretary announced in the 1993/94 Budget Speech that it was his intention to replace the Government Bond Programme with the Exchange Fund Note Programme. Exchange Fund Notes (“Notes”) are issued under the Exchange Fund Ordinance (Chapter 66 of the Laws of Hong Kong) and for the account of the Exchange Fund.

2. Currently Notes of two years, three years, five years, seven years and ten years to maturity are being issued at such times as the Monetary Authority may determine. Notes of other maturities may be offered from time to time at the discretion of the Financial Secretary. The specific amounts and maturities of Notes on offer through competitive or non-competitive tender on any given tender day will be announced at least four business days in advance of that tender day.

3. This Information Memorandum sets out the relevant details of the Note programme, including the tender arrangements and the procedures for application, payment and settlement. It also describes the arrangements envisaged for promoting secondary market liquidity in the Notes. These arrangements will be kept under regular review and a further Information Memorandum (or supplements to the Information Memorandum) will be issued if material changes are made.

Description of the Notes

4. The Notes will be issued by the Hong Kong Government for the account of the Exchange Fund under the Exchange Fund Ordinance (Chapter 66 of the Laws of Hong Kong).

5. Notes with a maturity of two years and upwards may be issued under this programme. Notes with a maturity shorter than 2 years may be issued from time to time at the discretion of the Financial Secretary. The Notes will be issued in denominations of HK\$50,000 each and higher integral multiples thereof as described in more detail in the section on tender arrangements.

Status

6. The Notes will constitute direct, unsecured, unconditional and general obligations of the Hong Kong Government for the account of the Exchange Fund and will rank *pari passu* with all other unsecured indebtedness of the Hong Kong Government for the account of, and payable from, the Exchange Fund from time to time outstanding and without preference one over the other by reason of priority of date of issue or otherwise. Information about the Exchange Fund is included in Annex A of this Information Memorandum.

Taxation

7. The Notes are exempt from profits tax and stamp duty in Hong Kong.

Currency

8. The Notes will be denominated in Hong Kong dollars. All payments in respect of subscription, redemption and interest will be made in Hong Kong dollars.

Form of the Notes

9. The minimum denomination of Notes is HK\$50,000. Notes will be issued in computerized book entry form only, through Securities Accounts maintained with the Monetary Authority. The Monetary Authority will operate Securities Accounts for Recognized Dealers and others through Recognized Dealers on request (see paragraph 50). Instructions to debit/credit the Securities Accounts to effect secondary market transactions will be accepted only through Recognized Dealers.

Interest

10. Each issue of Notes will bear a fixed rate of interest which will be announced in advance of each tender. Interest, rounded to the nearest cent (half a cent being rounded upwards) and calculated on the actual number of days in an interest period (being a period from and including an interest payment date (or in the case of the first interest period, the issue date of the relevant Notes) to but excluding the next interest payment date) (as may be adjusted in the manner described in paragraph 35) and on the basis of a 365-day year, will be paid semi-annually in arrears.

Redemption

11. The Notes will be redeemed at par at maturity in the manner described in the section of this Information Memorandum on settlement arrangements.

Governing Law

12. The Notes will be governed by and construed in accordance with the Laws of Hong Kong.

Tender arrangements

13. Tenders will be held at such time as the Monetary Authority may determine. If for any reason (e.g. typhoon) the tender day is not a business day, tenders will be held on the immediately succeeding business day (other than a Saturday)(which shall then be regarded as the tender day). At least four business days in advance of each tender day, the Monetary Authority will announce the amount(s) on offer through competitive or non-competitive tenders, the issue date(s) (which, being the day following the tender day, may be subject to adjustment in the circumstance set out above in this paragraph 13 or in paragraph 35), the maturity date(s) and the interest rate(s) of the Notes on offer. The announcement will be published on the Reuters screen (HKMAOOD), Bloomberg, the Telerate screen (9912), the Bridge News screen and in the press, or by any other means specified by the Monetary Authority. Applicants for Notes (including institutional and individual applicants) may apply through both competitive and non-competitive tenders held on the same tender day but Recognized Dealers are not permitted to apply for Notes on their own behalf, or on behalf of other Recognized Dealers, through the non-competitive tender procedure.

Competitive Tender Procedure

14. Tenders will be open only to Recognized Dealers. Anyone wishing to apply for the Notes on offer through the competitive tender procedure can only do so through a Recognized Dealer.

15. All tenders must be made in a form similar to the sample which is at Annex B of this Information Memorandum or in any other form prescribed by the Monetary Authority. Tenders must reach the Monetary Authority not later than 10:30 a.m. Hong Kong time on the tender day. They should be transmitted via a Central Moneymarkets Unit Terminal, tested facsimile or tested telex using the numbers already provided to Recognized Dealers or by any other means as may be advised by the Monetary Authority. All tenders submitted in a competitive tender will be binding and will not be revocable from 10:30 a.m. on the tender day.

16. Tenders must be made on a bid-price basis, subject to a minimum bid of HK\$50,000 each. Tenders above this minimum must be in integral multiples of HK\$50,000.

17. Applicants will be required to state in the tender the price (P_0), expressed as a percentage and rounded to two decimal places, and the nominal amount of Notes (F_0) tendered for at that price. The amount of payment (A_0) to be effected on settlement day should be calculated by the following formula:

$$A_0 = F_0 \times P_0$$

18. Tenders accepted will normally be allotted in descending order of price bid from the highest to the lowest accepted price. Applicants whose tenders are accepted will be allotted at the price at which they tendered. Subject to paragraph 23, tenders which are accepted and which are above the lowest accepted price will be allotted in full; those which are accepted and which are at the lowest accepted price may be allotted in full or in part only. In the case of allotment in part, a calculation will be made of the amount of Notes available for allotment at the lowest accepted price as a percentage (the "pro-rata percent") of the total amount of Notes applied for at that price. As far as possible the pro-rata percent will be applied to the amount of Notes tendered for by each applicant at the lowest accepted price and the result rounded down to the nearest multiple of HK\$50,000.

Non-competitive Tender Procedure

19. The Monetary Authority may reserve a portion of any issue of Notes for offer on a non-competitive tender basis. Non-competitive tenders will be open only to Recognized Dealers which are also appointed by the Monetary Authority as Retail Exchange Fund Notes Distributors. All applicants must therefore submit tender bids in a non-competitive tender through a Retail Exchange Fund Notes Distributor (a list of whom, as at 30 June 2003, is included at Annex D of this Information Memorandum, an updated list will be available on the Hong Kong Monetary Authority's website). Accordingly, references in this Information Memorandum to Recognized Dealers in the context of the non-competitive tender procedure and the settlement arrangements therefor shall, where the context so permits, be references to those Recognized Dealers who are appointed as Retail Exchange Fund Notes Distributors (provided however that for the avoidance of doubt the references to Recognized Dealers in the prohibition in paragraphs 13 and 39 on Recognized Dealers applying for Notes on their own behalf, or on behalf of other Recognized Dealers, in non-competitive tenders shall be references to all Recognized Dealers and not just Retail Exchange Fund Notes Distributors). In any non-competitive tender, only one non-competitive bid may be submitted for the benefit of any one person through the same Retail Exchange Fund Notes Distributor. Multiple applications or suspected multiple applications in a non-competitive tender made through the same Retail Exchange Fund Notes Distributor are liable to be rejected by the Retail Exchange Fund Notes Distributor.

20. Retail Exchange Fund Notes Distributors must submit non-competitive tenders in a form similar to the sample at Annex C of this Information Memorandum or in any other form prescribed by the Monetary Authority. Tenders must reach the Monetary Authority not later than 12:00 noon Hong Kong time on the business day (other than a Saturday) falling immediately before the tender day. If for any reason (e.g. typhoon) the business day (other than a Saturday) falling immediately before the tender day ceases to be a business day, the tenders must reach the Monetary Authority not later than 10:30 a.m. Hong Kong time on the tender day. The tenders should be transmitted via a Central Moneymarkets Unit Terminal, tested facsimile or tested telex using the numbers already provided to Retail Exchange Fund Notes Distributors or by any other means as may be advised by the Monetary Authority. All tenders submitted in a non-competitive tender will be binding and will not be revocable from 12:00 noon Hong Kong time on the business day (other than a Saturday) falling immediately before the tender day or, if the business day (other than a Saturday) falling immediately before the tender day ceases to be a business day for any reason (e.g. typhoon), from 10:30 a.m. Hong Kong time on the tender day.

21. Non-competitive tenders submitted by Retail Exchange Fund Notes Distributors on behalf of applicants will be required to state in the tender the nominal amount of Notes (F_1) tendered for. The average price (P_1) accepted at the competitive tender held on the same tender day, (which will be calculated as the mean of the prices of the competitive tender bids accepted, weighted by the allotment amounts) expressed as a percentage and rounded to two decimal places, will be the price required to be paid by successful bidders in the non-competitive tender. The amount of payment (A_1) to be effected on settlement day should be calculated by the following formula:

$$A_1 = F_1 \times P_1$$

22. Non-competitive tenders submitted by Retail Exchange Fund Notes Distributors on behalf of applicants which are accepted will be allotted Notes at the average price accepted at the competitive tender. Subject to paragraph 23, allotment in respect of non-competitive tenders will be made according to the following rules:

- (a) if the total subscription amount applied for through non-competitive bids is equal to or smaller than the amount of Notes on offer through non-competitive tender, all applicants will be allotted the full amount for which they tendered;
- (b) if the total subscription amount applied for through non-competitive bids exceeds the amount of Notes on offer through non-competitive tender AND the number of applications received is equal to or smaller than the quantity of Notes (based on the minimum denomination of HK\$50,000) on offer through non-competitive tender, a minimum of HK\$50,000 of the Notes will be allocated to each applicant. Notes remaining, if any, will be allocated to each applicant on a pro rata basis to the remaining quantity of Notes applied for by each applicant, rounded down to the nearest whole Note and in the case of Notes remaining after rounding, by ballot; and

- (c) if the total subscription amount applied for through non-competitive bids exceeds the amount of Notes on offer through non-competitive tender AND the number of applications received is larger than the quantity of Notes (based on the minimum denomination of HK\$50,000) on offer through non-competitive tender, a ballot will be held in respect of all non-competitive tender bids and those applicants who are successful in the ballot will each be allotted a Note of HK\$50,000 denomination.

Other tender arrangements

23. The Monetary Authority will set no minimum price on the Notes offered through the competitive tender and will expect to allot the whole amount on offer. If the amount of Notes reserved for non-competitive tender is under-subscribed, the Monetary Authority may add the non-subscribed portion back to the amount on offer through competitive tender. There are no formal or informal underwriting arrangements for the tenders but the Monetary Authority encourages all Market Makers and Recognized Dealers, as part of their commitment to the market, to participate actively in the tenders. The Monetary Authority reserves the right not to allot all the Notes on offer or to scale down the allotment to a successful bidder, either in competitive or in non-competitive tenders, though he would only consider doing so in exceptional circumstances, e.g. where the tender is made at an unacceptably deep discount to the prevailing market level or to avoid disproportionate market share by a market participant. The Monetary Authority reserves the right to acquire Notes at the tender at the lowest price bid in the event of undersubscription. The Monetary Authority reserves the right to require evidence from a Retail Exchange Fund Notes Distributor to verify that the Retail Exchange Fund Notes Distributor has not accepted multiple applications, and/or submitted more than one tender bid in a non-competitive tender, for the benefit of any one person.

24. The Monetary Authority may reopen a particular issue of Notes, in which case the original maturity of the Notes will remain unchanged. However, the amount to be paid for the new Notes in the reopened issue will include the settlement amount A_0 in paragraph 17 for successful competitive bids or A_1 in paragraph 21 for successful non-competitive bids, plus an amount equal to the interest accrued from the last interest payment date to the allotment date of the relevant new Notes. The accrued interest payable per minimum denomination of HK\$50,000 of the new Notes will be announced at least four business days in advance of the tender day.

25. Pursuant to the undertaking given in paragraph 38 of this Information Memorandum, the Monetary Authority will act as the last resort supplier of Notes to Market Makers and, for this purpose, additional Notes may be issued. If for any reason the amount of Notes allotted in any competitive tender is less than the full amount on offer, the unissued amount will be added to the amount of additional Notes and may be made available at any time before maturity.

26. Recognized Dealers whose tenders have been successful in whole or in part will be notified of their allotment of Notes and the amount payable as soon as practicable after the allotment. The amount of Notes allotted through the competitive or non-competitive tenders, and the lowest and average prices at which Notes have been allotted will be announced not later than 3:00 p.m. on the tender day on the Reuters screen (HKMAOOE), Bloomberg, the Telerate screen (9913), the Bridge News screen, or by any other means specified by the Monetary Authority.

Settlement arrangements

27. Payment for, and registration through the computerized book entry system of, Notes issued by tender will be for value on the business day, other than a Saturday, immediately following the tender day (the issue date). By submitting a tender on behalf of an applicant, the relevant Recognized Dealer agrees to pay for Notes awarded as a result of such tender. Settlement of payments will be made in the manner described in paragraphs 28 and 29 below. Settlement of payments between Recognized Dealers and their clients will continue to depend on the interbank payment system and traditional payment methods.

28. In the case of a Recognized Dealer which is a licensed bank, payment in Hong Kong dollars will be effected through its settlement account maintained with the Monetary Authority.

29. In the case of a Recognized Dealer which is not a licensed bank, payment in Hong Kong dollars will be effected as follows:

- (a) the Monetary Authority will debit the settlement account of the correspondent bank of that Recognized Dealer; and
- (b) the correspondent bank will debit the appropriate account of that Recognized Dealer.

30. The Monetary Authority will, on the issue date, credit the nominal value of the Notes allotted to Recognized Dealers to their Securities Accounts maintained with the Monetary Authority upon receipt of payments.

31. On the maturity date for any Notes issued, the Monetary Authority will arrange for the relevant computerized entries in the Securities Accounts to be reversed and for the settlement accounts of Recognized Dealers which are licensed banks to be credited in Hong Kong dollars with the relevant amounts of principal and interest payable upon maturity of the Notes. Payments to Recognized Dealers which are not licensed banks will be by way of credit to their bank accounts via their correspondent banks which will in turn have their settlement accounts credited. Settlement of payments between Recognized Dealers and their clients will continue to depend on the interbank payment system and traditional payment methods.

32. If a Market Maker fails to close its short position (see the section of this Information Memorandum on Market Making Arrangements by Market Makers and the Monetary Authority) in a particular issue before its maturity, the Monetary Authority will, on the maturity date, debit the Market Maker's settlement account or the settlement account of its designated correspondent bank with an amount equal to the nominal value plus accrued interest of the short position in the manner described in paragraphs 28 and 29 above.

33. On an interest payment date of any Notes, the Monetary Authority will arrange for the settlement accounts of Recognized Dealers which are licensed banks to be credited with the relevant amount of interest in Hong Kong dollars. Payment of interest to Recognized Dealers which are not licensed banks will be by way of credit to their bank accounts via their correspondent banks which will in turn have their settlement accounts credited. Settlement of payments between Recognized Dealers and their clients will continue to depend on the interbank payment system and traditional payment methods.

34. If a Market Maker incurs a short position on the day immediately preceding an interest payment day, the Monetary Authority will debit the Market Maker's settlement account or the settlement account of its designated correspondent bank with the relevant amount of interest in the manner described in paragraphs 28 and 29 above.

35. If the issue date specified for any issue of Notes for any reason (e.g. typhoon) is not a business day, payment by the successful bidders will be postponed to the immediately succeeding business day (other than a Saturday) which will then be deemed to be the issue date, however the interest payment dates and maturity date originally specified will remain unchanged. If the maturity date or any interest payment date specified for any issue of Notes is not a business day, the payment of principal plus interest or interest will be made on the immediately succeeding business day (other than a Saturday) which will then be deemed to be the maturity date or interest payment date as the case may be. In the latter case, all subsequent interest payment dates and the maturity date specified for the issue will remain unchanged. In both cases, the interest payable will be adjusted to include interest accrued during the deferred period. Recognized Dealers should refer to the prevailing typhoon procedures specified by the Monetary Authority from time to time.

Recognized Dealers and Market Makers

36. Tenders will be accepted only from Recognized Dealers and in the case of non-competitive tenders from those Recognized Dealers which have also been appointed as Retail Exchange Fund Notes Distributors. All Recognized Dealers in accepting their appointments shall give the following undertakings to the Monetary Authority:

- (a) to comply with market regulations that may be specified from time to time by the Monetary Authority;
- (b) to supply relevant statistics that may be required by the Monetary Authority to enable him to monitor developments in the market;
- (c) to allow the Monetary Authority or a person nominated by him to inspect their books and records relating to Notes to the extent permitted by law;
- (d) to give timely instructions to the Monetary Authority for any transfer of Notes in the manner specified by him; and
- (e) to inform their clients who are not Recognized Dealers that they may open a Securities Account with the Monetary Authority through a Recognized Dealer (see paragraph 50) and of the terms of issues of Notes.

37. A number of Recognized Dealers have been additionally appointed as Market Makers. Market Makers must give an undertaking to the Monetary Authority that they will maintain a market in the Notes by quoting bid and offer prices for the Notes during normal money market hours (between 9:00 a.m. to 12:00 noon and 2:00 p.m. to 4:00 p.m. Monday to Friday). Market Makers are expected to take an active part in the primary and secondary markets. In addition, they are also expected to promote the Note Programme so as to broaden the investor base.

38. In return the Monetary Authority will give the following undertakings to Market Makers:

- (a) he will only buy and sell Notes in the secondary market through Market Makers;
- (b) he will make a bid to Market Makers for Notes they may offer;
- (c) he will act as last resort supplier of Notes to Market Makers subject to suitable arrangements being entered into with the Market Makers; and
- (d) he will announce the amounts of Notes outstanding on a regular basis.

39. In order to promote the Notes in the retail market, the Monetary Authority may appoint a number of Recognized Dealers (including Market Makers) as Retail Exchange Fund Notes Distributors. The Retail Exchange Fund Notes Distributors are allowed to submit tenders on behalf of applicants to subscribe for Notes on offer through non-competitive tender but they are not allowed to submit bids in non-competitive tenders on behalf of themselves or on behalf of other Recognized Dealers. Retail Exchange Fund Notes Distributors are required to comply with certain standards in the distribution of the Notes in the retail market as promulgated by the Monetary Authority from time to time.

Transfers of Notes between Securities Accounts of Recognized Dealers maintained with the Monetary Authority

40. Notes can be transferred from one Recognized Dealer's Securities Account to another through book entries. The Recognized Dealers involved in the transfer are required to send their instructions to the Monetary Authority.

41. Transfer instructions should be transmitted to the Monetary Authority via a Central Moneymarkets Unit Terminal, facsimile or telex using the numbers already provided to Recognized Dealers or by any other means as may be advised by the Monetary Authority.

42. All transfer instructions must reach the Monetary Authority by 2:30 p.m. in the case of instructions transmitted by facsimile or telex or by 3:00 p.m. in the case of instructions submitted by Central Moneymarkets Unit Terminal on the day on which the transfer is to be effected (i.e. the settlement date). The Monetary Authority reserves the right not to process any transfer instructions received after the deadline. In such circumstances, late transfer instructions would have to be re-submitted on the next business day.

Market Making Arrangements by Market Makers and the Monetary Authority

43. In order to create a liquid secondary market for the Notes and to avoid any issue being cornered, Market Makers will be allowed to incur short positions during the day subject to the requirements and procedures set out below. A Market Maker may hold a short position provided that:

- (a) the Market Maker's appointment has not been revoked by the Monetary Authority nor has the Market Maker's authority to incur short positions otherwise been terminated by the Monetary Authority;
- (b) the short position is within the margin limit imposed by the Monetary Authority on the Market Maker (if any); and
- (c) the Market Maker holds, as sole beneficial owner and free from any security or other interest, long positions in other Exchange Fund Bills and Notes and such other instruments as the Monetary Authority may specify as Eligible Securities for Market Making Arrangements which are sufficient to cover the short position.

44. A Market Maker which holds a short position in an issue at 4:00 p.m. on a business day or such other time as the Monetary Authority may specify, must close its short position by entering into a Sale and Repurchase Agreement (“Repo”) with the Monetary Authority. Through the Repo, the Market Maker will purchase from the Monetary Authority the amount of the particular issue of Notes necessary to cover the short position, and will sell to the Monetary Authority Eligible Securities acceptable to the Monetary Authority of sufficient market value calculated in accordance with a formula determined by the Monetary Authority. The Monetary Authority will credit the Securities Account of the Market Maker with the amount of Notes necessary to close the short position.

45. By 3:30 p.m. or such other time as the Monetary Authority may specify on the next business day (other than a Saturday), the Market Maker will sell and the Monetary Authority will purchase an equivalent amount of Notes to those originally sold under the Repo. The Monetary Authority will debit the Securities Account of the Market Maker with the number of Notes of the relevant issue that the Market Maker has sold.

46. The Monetary Authority reserves the right to set a limit on the value of Repo transactions an individual Market Maker may enter into with the Monetary Authority.

47. Failure by a Market Maker to close its short position on any trading day may result in the rejection by the Monetary Authority in whole or in part of any outstanding unsettled transfer instructions received on that day involving that Market Maker as a counterparty.

48. A Market Maker must inform the Monetary Authority if any of its holdings of Eligible Securities have been pledged to another party. Any Eligible Securities so pledged will not be acceptable for Repo transactions.

49. In the event that a Market Maker closes its short position in any issue of Notes by entering into a Repo with the Monetary Authority on the day before the Notes’ maturity, the Market Maker will unconditionally accept that the Monetary Authority will debit its settlement account or the settlement account of its designated correspondent bank, in addition to any other rights available to him at law, at any time and without notice to the Market Maker concerned, with an amount equal to the nominal value plus accrued interest of the short position in the manner described in paragraphs 28 and 29 above.

50. Each Recognized Dealer will have at least two Securities Accounts in the Register maintained by the Monetary Authority – one for its own holdings and the other for the holdings of its clients. In addition, a Recognized Dealer may also request that specific custody accounts be opened for any of its clients who may wish their Notes to be held by the Recognized Dealer in a separate account designated with the client’s name. These clients may then sell Notes under their names through the Recognized Dealer, i.e. instruction for the transfer of title before maturity must be routed through that Recognized Dealer. Legal title to Notes is vested in the holder of the Securities Account to which the Notes are credited.

HONG KONG MONETARY AUTHORITY
August 2003

THE EXCHANGE FUND

Origin and purpose

The Fund was constituted by the Currency Ordinance of 1935, later renamed the Exchange Fund Ordinance (Chapter 66 of the Laws of Hong Kong). Section 3(1) of the Ordinance as amended specifies that the Fund “shall be under the control of the Financial Secretary and shall be used primarily for such purposes as the Financial Secretary thinks fit affecting, either directly or indirectly, the exchange value of the currency of Hong Kong and for other purposes incidental thereto.”

2. In addition the Financial Secretary may “use the Fund as he thinks fit to maintain the stability and integrity of the monetary and financial systems of Hong Kong”, with a view to “maintaining Hong Kong as an international financial centre”.

Liabilities and Reserves of the Fund

3. There are seven main items. These are:

- (a) Certificates of Indebtedness issued to the note-issuing banks as cover for banknotes lawfully issued by them. These Certificates of Indebtedness are issued against payment to the Financial Secretary, for the account of the Exchange Fund, of the face value of such Certificates. Under the linked exchange rate system, the payment is denominated in US dollars at the fixed rate of HK\$7.80 to US\$1. These Certificates are non-interest bearing. As at 31 December 2002, the total face value of the Certificates of Indebtedness outstanding was HK\$118.5 billion.
- (b) Money transferred from the general revenue and other Funds to the Exchange Fund. As at 31 December 2002, the total outstanding amount of money transferred was HK\$301.7 billion. With effect from 1 April 1998, these sums transferred share in the overall return of the Exchange Fund.
- (c) Government-issued currency notes and coins in circulation. As at 31 December 2002, these amounted to HK\$5.9 billion.
- (d) Balance of the banking system, in the form of the balances in the settlement accounts maintained by the banks with the Monetary Authority for the account of the Exchange Fund. Such settlement accounts were opened on 9 December 1996 in accordance with the Financial Secretary’s Notice of 16 November 1996 under Section 3A(1) of the Exchange Fund Ordinance. On 31 December 2002, the aggregate of closing balances in these settlement accounts was HK\$0.5 billion.
- (e) Placements by banks and other financial institutions. As at 31 December 2002, these amounted to HK\$36.3 billion.
- (f) Placements by Hong Kong statutory bodies. As at 31 December 2002, these amounted to HK\$4.3 billion.
- (g) Accumulated net earnings of the Exchange Fund. On 31 December 2002, the latest date for which figures are publicly available, these stood at HK\$327.2 billion.

Assets of the Fund

4. For liquidity reasons, the Fund is mainly held in assets denominated in the USD and other OECD currencies. Part of the Fund is placed on interest bearing deposits with first class banks in Hong Kong and overseas, and part is invested in a variety of financial instruments, including bonds, notes and treasury bills.

Investment and management of the Fund

5. The Fund is under the control of the Financial Secretary. His control, as specified in the Exchange Fund Ordinance, is exercised in consultation with an Exchange Fund Advisory Committee of which the Financial Secretary is the ex officio chairman and of which the other members are appointed by the Chief Executive. Members currently sitting on the Exchange Fund Advisory Committee are:

The Monetary Authority

Mr. E. Mervyn DAVIES, C.B.E

Mr. Marvin CHEUNG Kin-tung, SBS, JP

Mr. David ELDON, JP

Professor Richard Y C WONG, SBS, JP

Dr. The Hon. David LI Kwok-po, LLD, GBS, JP

Mr He Guangbei

Dr. James Z M KUNG, OBE

Mr. Christopher CHENG Wai-chee, JP

Mr. Victor LO Chung-wing, GBS, JP

Mr. Robert C. TANG, SC, JP

Mr. Patrick WANG Shui-chung, JP

6. The day-to-day management of the Fund is delegated to the Monetary Authority. Part of the Fund is directly managed by the Monetary Authority and part by appointed managers both inside and outside Hong Kong. The performance of investments managed by each appointed manager is regularly compared with that of those managed by other appointed managers and those managed directly by the Monetary Authority.

MARKET MAKER (MM) AND RECOGNIZED DEALER (RD) LIST**As of 30 June 2003**

ABBEY NATIONAL TREASURY SERVICES PLC	CHIYU BANKING CORPORATION LIMITED
ABN AMRO BANK N.V.	CHO HUNG FINANCE LIMITED
AGRICULTURAL BANK OF CHINA	CHUGOKU BANK, LTD (THE)
ALLIED BANKING CORPORATION (HONG KONG) LIMITED	CITIBANK N.A.
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